

California Fair Political Practices Commission
MEMORANDUM

To: Chairman Getman, Commissioners Downey, Knox, Scott, and Swanson
From: William L. Williams, Jr., Staff Counsel
John W. Wallace, Assistant General Counsel
Luisa Menchaca, General Counsel
Subject: Conflict of Interest Regulations Improvement Project-Status Report and Pre-notice
Discussion of Proposed Amendments to Regulations 18232, 18705.5, and 18708
Date: October 1, 2001

INTRODUCTION/OVERVIEW

The Political Reform Act¹ (the Act) prohibits a public official from making, participating in making or otherwise using his or her official position to influence a governmental decision in which the official has a financial interest. (§ 87100 et seq.) An eight-step analysis is applied to determine whether a public official has a conflict of interest in a given governmental decision as follows:

Step One: Is the individual a “public official?”

In this step, the threshold determination is made as to whether the individual comes within the purview of the Act in his or her official capacity. Generally speaking, all significant governmental decision-makers are public officials under the Act.

Step Two: Is the public official making, participating in making, or influencing a governmental decision?

In this step, the nature of the public official’s participation in a given governmental decision is examined to assure that he or she is actually involved in making a governmental decision, as opposed to a private decision, within the meaning of the Act.

Step Three: What is the “economic interest” of the public official?

In this step, the economic interest that may give rise to a potential financial interest in a given governmental decision is examined. The various economic interests of a public official are as follows:

Business Interests. An official has an economic interest in a business entity in which the official, the official’s spouse, or the official’s dependent children or anyone acting on the official’s behalf has invested \$2,000 or more, or in which the official is a director, officer, partner, trustee, employee, or holds any position of

1. Unless otherwise specified herein, all citations are to the Act at Government Code sections 81000 – 91014. All regulatory citations are to Commission regulations at Title 2, sections 18109 – 18997, of the California Code of Regulations.

management.

Real Property. The official has an economic interest in real property in which the official, the official's spouse, the official's dependent children or anyone acting on the official's behalf has invested \$2,000 or more (including leasehold interests).

Sources of Income. The official has an economic interest in anyone, whether an individual or an organization, from whom the official has received (or by whom the official has been promised) \$500 or more in income within the 12 months prior to the decision.

Sources of Gifts. The official has an economic interest in anyone, whether an individual or an organization, which has given the official gifts totaling \$320 or more within the 12 months prior to the decision.

Personal Finances. The official has an economic interest in the official's personal expenses, income, assets, or liabilities, as well as those of the official's immediate family--this is known as the "personal financial effects" rule. If these are likely to go up or down as a result of the governmental decision, then it has a "personal financial effect" on the official.

Step Four: Are the public official's economic interests directly or indirectly involved in the decision?

In this step, the nature of the involvement of the public official's economic interest in the governmental decision is examined. Depending on the type of economic interest involved, different standards are applied to determine whether an economic interest is directly or indirectly involved in a governmental decision. This is a very important step in the analysis, in that where an economic interest is directly involved in a governmental decision, more stringent rules are applied in determining whether a decision has a disqualifying effect on the official's economic interest under subsequent steps in the conflicts analysis.

Steps Five and Six: Will the financial effect of the decision on the public official's economic interests be material and reasonably foreseeable?

While these are distinct steps in the analytical framework, they are usually combined to determine whether a decision will have a reasonably foreseeable material financial effect on the official's economic interest. This is really the heart of conflicts analysis, where it is determined if a conflict of interest exists for the official under the Act.

Steps Seven and Eight: Does the governmental decision come within any exception to the conflict-of-interest rules?

There are two exceptions with many variants. These exceptions are applied to allow a public official with a conflict of interest to still participate in the governmental decision. The first of these exceptions is for decisions where the effect on the public official's economic interest(s) is not different from the effects on the economic interest(s) of the "public generally." The second exception is applied where the participation of the public official is "legally required."

The Conflict-of-Interest Regulations Improvement Project

In May 1998, the Commission initiated the Conflict of Interest Regulations Improvement Project and divided it into two phases. Phase 1 involved the restructuring of the regulations into a more "user-friendly" format without making substantive changes. Phase 2 was intended to deal with substantive amendments to the conflict-of-interest regulations. During the course of the adoption of the regulations, the Commission requested that staff survey the impact of these regulations and provide the Commission with a status report on the implementation of the regulatory changes in October of 2001. On July 27, 2001, staff surveyed the regulated community in conjunction with an interested persons meeting regarding the impact of the implementation of the Phase 2 regulatory changes.

In this memorandum staff will provide a status report on the implementation of the Phase 2 and present for pre-notice discussion a number of proposed technical and substantive amendments to the regulations based upon input from the regulated community and staff review of issues that have arisen over the past year.

STATUS REPORT/RECOMMENDATIONS

Regulation 18230: New Regulation 18230 was enacted to define "doing business in the jurisdiction" for purposes of Sections 82030, 82034, and 87209 which define "income," "investment," and "business positions," respectively.

Input from the regulated community and staff indicates that there are no present problems with application of this regulation. Staff will continue to monitor application of this regulation.

Regulation 18232: Section 82030(b)(2) excludes from the statutory definition of "income" certain payments to an official from state, local, or federal government agencies. New Regulation 18232 provides definitions to the terms used in this exception such as "salary" and "per diem." Among the items included under the definition of "salary" are "consultants' fees." There is concern that the term "consultants' fees" as used in the regulation may be construed too broadly to include independent contractor fees paid to persons not defined as a "consultant" under regulation 18701(a)(2). This would be a change from prior advice that the exception only applies where the individual is a "consultant" as defined in Regulation 18701. Staff is recommending a clarifying amendment specifically delineating the scope of the exception and bringing the exception in line with past advice. This can be accomplished by referencing the definition of

“consultant” contained in regulation 18701(a)(2) to comport with the Commission’s intent as to the scope of the exclusion of “salary” from income.

Another clarifying change is the deletion of the introductory phrases “For purposes of this section...” in subdivisions (b) and (c) of the regulation. This language is being deleted because it is unnecessary and confusing in light of the introductory sentence to the regulation.

Staff Recommendation: That the Commission adopt the draft language effectuating this clarifying change. The draft language is attached in Appendix E.²

Regulation 18702.1: Regulation 18702.1 sets forth an official’s obligations after an official determines that a conflict of interest exists. In December 2000, the Commission determined that the mandatory disclosure requirements with respect to the nature of the conflict of interest should be made permissive.

Input from the regulated community and staff indicate that there are no present problems with application of this regulation. Staff will continue to monitor application of this regulation.

Regulation 18704.2: Regulation 18704.2 sets out a list of factual situations in which an official’s real property interest is considered directly involved in a governmental decision. In December of 2000, the Commission added two situations (formerly defined as “indirect” situations) into Regulation 18704.2. These provisions dealt specifically with (a) real property located within 300 feet of the boundaries (or proposed boundaries) of the real property which is the subject of the governmental decision, and (b) decisions involving the construction of, or improvements to, streets, water, sewer, storm drainage or similar facilities. In connection with this relocation of text, the Commission also increased the distance at which an official’s real property is considered to be directly involved from 300 feet to 500 feet. The resultant and current language of Regulation 18704.2 is as follows:

“(a) Real property in which a public official has an economic interest, is directly involved in a governmental decision if that real property is the **subject of the governmental decision**, or if any part of that real property is located within 500 feet of the boundaries (or proposed boundaries) of the real property which is the **subject of the governmental decision**. Real property is the "**subject of the governmental decision**" if:

“(1) The governmental decision involves the zoning or rezoning, annexation or deannexation, sale, purchase, or lease, or inclusion in or exclusion from any city, county, district or other local governmental subdivision, of the real property, or a similar

2. Draft language for all regulatory amendment proposals is contained in Appendix E, attached hereto.

decision affecting such real property;

“(2) The governmental decision involves the issuance, denial or revocation of a license, permit or other land use entitlement authorizing a specific use or uses of such real property;

“(3) The governmental decision involves the imposition, repeal or modification of any taxes or fees assessed or imposed on such real property; or

“(4) The governmental decision is to designate the survey area, to select the project area, to adopt the preliminary plan, to form a project area committee, to certify the environmental document, to adopt the redevelopment plan, to add territory to the redevelopment area, or to rescind or amend any of the above decisions; and real property in which the official has an interest, or any part of it is located within the boundaries (or the proposed boundaries) of the redevelopment area. For purposes of this subdivision, real property is located "within 500 feet of the boundaries (or proposed boundaries) of the real property which is the **subject of the governmental decision**" if any part of the real property is within 500 feet of the boundaries (or proposed boundaries) of the redevelopment project area.

“(5) The decision involves construction of, or improvements to, streets, water, sewer, storm drainage or similar facilities, and the real property will receive new or improved services. As used in this subdivision, "new or improved services" do not include repairs, replacement, or maintenance of existing services.

“(6) For purposes of this subdivision, the terms "zoning" and "rezoning" shall refer to the act of establishing or changing the zoning or land use designation on the subject property. The terms "zoning" and "rezoning" shall not refer to an amendment of an existing zoning ordinance or other land use regulation (such as changes in the uses permitted, or development standards applicable, within a particular zoning category) which is applicable to all other properties designated in that category, which shall be analyzed under Title 2, California Code of Regulations, section 18705.2(b).” [Emphasis added.]

The analysis of whether a real property interest is directly or indirectly involved in a governmental decision is often outcome determinative as to the ultimate issue of the existence of a disqualifying conflict of interest for a public official. This is because the financial effect of a decision on “directly” involved real property is presumed to be material, whereas the effect on “indirectly” involved real property is presumed to be nonmaterial. (Reg. 18705.2.)

In this regard, an issue has arisen as to whether the “500 foot rule” embodied in Regulation 18704.2 is applicable only to the decisions expressly set forth in the regulation, or whether it can be applied to decisions that are not expressly included in the regulation. A literal reading of the new language would limit the “500 foot” test only to those decisions listed in (a)(1) through (a)(6). In other words, an official with real property within 500 feet (or 50 feet for that matter) of real property subject to a decision not expressly listed in (a)(1) through (a)(6) would be subject to a presumption of nonmateriality.

A review of the regulatory file indicates that current regulation 18704.2 was the product of two distinct efforts, the first being to make a simpler rule for determining the materiality standard for decisions involving real property by going to a single 500 foot rule, as opposed to the previous 300-2500 rule with variable materiality standards. Combined with the new “500 foot” rule, was the wording of the introductory language to the sections setting forth when a public official’s real property is “the subject of a governmental decision.” It is not clear that in approving this regulatory language, the Commission ever considered that it might be limiting the application of the 500 foot rule. In fact, two of the appendices to Commission memoranda on the regulatory amendment could leave the impression that application of the new 500 foot rule was not limited to only those decisions set forth in the regulation. Those appendices are attached hereto for your reference. (See Appendix A.) Nothing in the regulatory materials associated with this regulatory amendment shows any discussion of this consequence. The Commission minutes also do not indicate that this issue was discussed. This may be an unintended consequence. Therefore, staff is bringing this issue to the Commission for resolution.

Because this is a major policy issue as to the appropriate scope of the application of the “500 foot rule” as adopted by the Commission, staff is requesting that the Commission clarify its intent on this issue. If the Commission intends that the 500 foot rule be applied only with regard to the expressly stated decisions set forth in the regulation, no change in the language is necessary. If the Commission intends that the 500 foot rule have a broader reach, staff requests direction in that regard and will draft language effectuating the same for presentation to the Commission at a future Commission meeting.

Staff Recommendation: Staff is making no recommendation with regard to this policy issue.

Another related issue that has arisen regarding the scope of decisions to which are covered under the regulation, involves general plan amendments. Some agencies are viewing general plan amendments as coming with the purview of “zoning or rezoning” decisions under subdivisions (a)(1) and (a)(6) of the regulation. Because general plans cover the entire jurisdiction, officials of these agencies believe that cannot participate in such decisions unless the “public generally” or “legally required participation” exceptions apply. This results in substantial difficulties, in that all of the members of a governing board of an agency may be unable to participate in some of the most fundamental decisions affecting the entire jurisdiction. At this point, only preliminary input has been received from the regulated community on the exact nature and scope of this issue.

Staff Recommendation: Staff solicit further input from the regulated community on this issue, and the scope of decisions that are being affected. Thereafter, staff is to report to the Commission on the issue, and whether the regulation should be modified to alleviate such problems.

Regulation 18705.1: Regulation 18705.1 sets forth the materiality standards applicable to business entities in which the public official has an interest. The Commission adjusted the indirect materiality thresholds to reflect changes resulting from inflation since the original adoption of the regulation. The regulation also references the listing criteria for various stock exchanges as an alternative benchmark for the application of graduated materiality standards based on the size of the business. Put another way, these are self-adjusting benchmarks that correlate different materiality standards to different sized businesses.

There has been some feedback from the regulated community to the effect that the complexity of the listing criteria for the various exchanges makes them difficult for officials to use in determining the appropriate materiality standard for a business interest. The assertion is that a public official cannot tell without extensive analysis whether a given business investment meets the criteria for listing on a given stock exchange.³ Staff is currently examining this issue. The initial review of the listing criteria for the various exchanges does bear out the regulated community's contention as to the complexity of the listing criteria. (For illustrative purposes, a copy of the Nasdaq listing requirements is attached as Appendix B.) However, to strike an appropriate balance between "user-friendly" criteria and criteria that accurately gauge the size of a given business, it will take further research and work by staff to develop alternatives for Commission consideration.

Staff Recommendation: That the Commission direct staff to prepare for its consideration new materiality criteria that have the flexibility of the exchange listing criteria, but are not as difficult to use for the regulated community. The new criteria would be presented to the Commission next year following an "Interested Persons" meeting.

Regulation 18705.5: This regulation sets out exceptions to the "personal financial affects" rule of section 87103. In December of 2000, the Commission reaffirmed the existing rule that the personal financial effects test would not be applied in cases where the potential conflict of interest could be analyzed under a more specific regulation, such as the regulations for business entities or real property. Input from the regulated community indicates that this regulation is working well in practice.

Staff is proposing a clarifying modification to the regulation to assure that indirect interests in businesses will not be analyzed as a personal financial effect. This is consistent with the Commission's intent that potential economic interests be analyzed under the more specific regulations if possible, and is also consistent with staff's current interpretation of the regulation.

3. Obviously, where a business is actually listed, no such determination need be made. This is only a problem for businesses that qualify for listing but that are not currently listed.

Staff Recommendation: That the Commission adopt the draft language effectuating this clarifying change. The draft language is attached in Appendix E.

Regulation 18706: This regulation sets out the definition of “foreseeability.” Since the beginning of the project, redefining foreseeability has been an issue. Foreseeability will be discussed in a separate memorandum on this agenda.

Regulation 18707.1: Regulation 18707.1 defines “significant segment” in a variety of different circumstances.

Staff has received input from the City of Yountville that the “significant segment” analysis for real property interests under this regulation in its use of the terms “all property owners or all homeowners” (as the mathematical universe to which to apply the percentage thresholds) causes problems in its jurisdiction. Evidently, mobile home park dwellers make up a significant portion of the populous. The problem arises in that there may be numerous mobile home dwellers on property owned by very few people. (A copy of the Yountville city attorney’s letter is contained in Appendix C, attached hereto.) The city would like to include the term “households” as an additional alternative mathematical universe to which to apply the percentage thresholds. Staff disagrees with this suggestion. The term “households” was specifically considered and deleted from the regulation to dispel previous ambiguities in that regard. Also, as the regulation is dealing with application of the “public generally” exception in the context of an interest in real property, the mathematical universe for application of the percentage thresholds should be a form of real property ownership. The term “households” would obviously encompass interests that are not ownership interests in real property.

Staff Recommendation: That the Commission take no action to modify the language in this regulation.

Regulation 18707.3: Regulation 18707.3 provides an exception geared specifically toward small jurisdictions. Several amendments were made to this regulation to make it consistent with the amended materiality regulations applicable to real property.

The City of Yountville has also raised concerns with the application of this regulation in that it incorporates the “500 foot rule” as one of the preconditions for application of the “public generally” exception for small jurisdictions. Basically, when a circle is drawn using a 500 foot radius from the residences of city council members, the resultant areas encompass much of the town. Staff is currently reviewing the regulation to see if language can be tailored to meet this unique concern of small cities.

Staff Recommendation: That the Commission take no action to modify this regulation at this time, and that staff present a status report to the Commission with regard to this issue during next year’s

regulatory calendar.

Regulation 18707.4: Regulation 18707.4 was not subject to amendment in the course of the project. This regulation provides a special variant of the “public generally” exception for members appointed to boards and commissions for the purpose of representing a specific interest or group. Issues have arisen regarding the scope of this exception. These issues will be presented by separate memorandum for next month’s meeting.

Regulation 18707.7: This regulation establishes when a substantially similar financial effect on a single industry, trade or profession can qualify for this exception. In December 2000, a 50 percent threshold was inserted into this regulation.

Input from the regulated community and staff indicate that there are no present problems with application of this regulation. Staff will continue to monitor application of this regulation.

Regulation 18707.9: In December 2000, the Commission adopted new Regulation 18707.9. This first subdivision in the regulation was a codification of *In re Ferraro* (1978) 4 FPPC Ops. 62, and *In re Overstreet* (1981) 6 FPPC Ops. 12. In addition, the Commission also created a new exception specifically applicable to a public official’s economic interest in real property in the context of rent control and similar decisions.

Input from the regulated community and staff indicates that there are no present problems with application of this regulation. Staff will continue to monitor application of this regulation.

Regulation 18708: If a public official has a disqualifying conflict of interest in a governmental decision, he or she may still participate in a decision if such participation is “legally required.” Regulation 18708 sets forth the standards for this exception. In December of 2000, the Commission clarified the disclosure requirements under the exception. Input from the regulated community and staff indicates that there are no present problems with application of this regulation. However, we have received a request to clarify an ambiguity in the language. The regulation, as currently written, provides for a 30-day period from the time of the decision to prepare a disclosure document, but does not specify a time for placement of the document in a public file maintained by the agency. The commenter and staff believe that the Commission intended the writing and filing to occur within 30 days. Staff is proposing a clarifying amendment to the effect that preparation of the disclosure document and its placement in a public file will occur within the same 30-day time frame from the decision.

Finally, in December 2000, the question was raised whether a “substantial compliance” exception was needed for the disclosure rules in this regulation. A substantial compliance provision, as originally contemplated, would read something to the effect: “Where an agency substantially complies with the disclosure requirements of this regulation, a court shall not invalidate the decision made based on that

disclosure.” Staff specifically solicited comment as to the need for such an exception, and no one advocated its inclusion. Interested persons felt that the express statement of required disclosure added during Phase 2 resolved the problem created by the old regulation. Staff is concerned that expressing a principle of substantial compliance would inject unnecessary uncertainty into a regulation that is working well without it.

In addition to the lack of necessity for the exception, irrespective of its express inclusion in the regulation, the principle of substantial compliance can still be applied in mitigation of conduct at any stage of an enforcement proceeding.

Staff Recommendation: That the Commission adopt the clarifying amendment regarding the time frame for placing the disclosure document into the public file, and that the Commission take no action regarding inclusion of a “substantial compliance” element to this regulation.

Appendices: A. Appendices to Last Year’s Commission Memoranda
B. Nasdaq Listing Requirements
C. City of Yountville Letter
D. Regs. 18232
18705.5
18708